

II. LOCAL SERVICE: THE TRANSACTION CREATES POTENTIALLY LARGE BENEFITS TO CONSUMERS AND SHOULD RAISE NO COMPETITIVE CONCERNS

A. THE COMPLEMENTARY STRENGTHS OF WORLDCOM AND MCI ENHANCE THE LIKELIHOOD OF TIMELY AND SIGNIFICANT ENTRY INTO LOCAL SERVICE

7. A principal goal of the Telecommunications Act of 1996 is to stimulate competition in the provision of local exchange services. As suggested by Table 1, however, this goal remains unfulfilled. Nor is it clear when the goal of significant local exchange competition will be achieved. The proposed transaction, however, promises to accelerate that process.

1. WorldCom and MCI have complementary assets

8. Given the nascent state of local competition today, it is not possible to estimate with precision the extent to which the proposed transaction will accelerate the entry of competitive local exchange carriers (CLECs) into the provision of local exchange services. Nonetheless, available evidence and analysis suggest that the proposed transaction enhances the likelihood of success of such efforts by combining complementary assets of each company.

9. Among CLECs, WorldCom is perhaps furthest along in terms of constructing local access facilities. According to the FCC, at the end of 1996, WorldCom/MFS served more than 13,000 buildings in 23 states, a far greater number than reported by any other competitive access provider (CAP).² MCI, on the other hand, has a large base of residential and business customers, and a well-established brand name as well as local exchange facilities being deployed in a number of cities.

10. By combining WorldCom's networks and expertise with MCI's brand name, large customer base and existing infrastructure, MCI WorldCom will be able to more

2. FCC, Fiber Deployment Update End of Year 1996, Table 15.

Table 1

Gross Revenue by Type of Carrier

	1995		1996	
	\$ million	Percent	\$ million	Percent
CAPs and CLECs	623	0.6%	1,011	0.9%
LECs	102,820	99.4%	107,905	99.1%

Source: FCC, TRS Fund Worksheet Data (Nov. 1997).

efficiently provide and market a range of telecommunications services. In particular, MCI WorldCom will be in a position to provide "one stop shopping" by offering a package of local, long-distance and Internet services to a large number of customers, including multi-location customers. As Prof. Jerry Hausman claims in an affidavit submitted in support of petitioner BellSouth's application to provide within-region long distance services, "[m]ost students of telecommunications agree that customers want some degree of one-stop shopping."³

11. The FCC's Bell Atlantic/NYNEX Order also suggests that the "brand name" of established long distance carriers can significantly facilitate entry into the provision of local services. Apart from Bell Atlantic, the FCC considered AT&T, MCI, and Sprint to be "the most significant" potential entrants in the provision of local exchange services in New York City. The FCC found that the established long distance carriers "distinguish themselves from the universes of actual and precluded competitors and of other market participants by their experience and strong brand reputation in the provision of telephone service to the mass market."⁴ The FCC also cites a customer preference survey that identified AT&T, Sprint, and MCI as having strong brand reputations.⁵

2. The transaction is likely to result in significant cost savings and synergies in the provision of local services as well as other services

12. WorldCom claims that the transaction will result in significant cost savings and synergies in the provision of local, long-distance and international services. WorldCom claims that the proposed transaction will result in "pre-tax cash operating synergies" of about 12

3. Declaration of Professor Jerry A. Hausman, Appendix D to Bell South petition, ¶¶7.

4. Bell Atlantic/NYNEX Order, ¶¶70.

5. Ibid, ¶82.

percent of the combined (stand alone) operating expenses of the two firms by 2002.⁶ In addition WorldCom estimates capital expenditure savings of 23 percent for deploying the same (or more) network capacity, compared to costs expected on a stand alone basis.⁷

13. Petitioners question these efficiencies and claim that they are insufficiently documented. While we have not independently reviewed these calculations, it is important to note that investment analysts generally appear to attach credibility to these estimates. For example, Credit Suisse First Boston, commenting on WorldCom's preliminary estimates of cost savings, concluded:

"[o]n the face of it, \$20 billion in cost savings is too large a figure to fathom. ... Digging a bit deeper, we think the number does make sense. ... By pumping more revenues through the same pipeline and generating a better mix of revenues (local plus long distance plus Internet), we think this increase is achievable"⁸

A report from Merrill Lynch concludes simply that "[s]ynergies for the MCI merger are enormous."⁹

14. More generally, it is well recognized by industry analysts that significant benefits can be achieved by combining CLECs (WorldCom) and interexchange carriers (MCI). A Lehman Brothers, Inc. report, for example notes:

"We believe that consolidation of the CLEC and long distance sectors can drive significant revenue and cost synergies and gains in shareholder value. ... The recently announced MCI-WorldCom deal clearly highlights the value of consoli-

-
6. These savings include reduced domestic network costs, such as leased line and access costs; reduced costs of terminating international traffic; avoided costs in MCI's local activities, including sales, marketing and administrative expenses and core SG&A.
 7. WorldCom Inc., Amendment No. 3 to Form S-4, January 22, 1998, pp. 40-44.
 8. Credit Suisse First Boston Corporation, WorldCom Inc. -- Company Report, November 18, 1997, p. 4.
 9. Merrill Lynch Capital Markets, WorldCom/MCI -- Company Report, November 12, 1997, p. 3.

dation and simultaneously accelerates the need for all competitors to respond to the challenge it presents....

[S]peed to market is especially important given the increase in competition that we expect to see from large competitors over the next year. The MCI-WorldCom deal has clearly upped the ante and time frame for all competitors".¹⁰

B. SUCCESSFUL LOCAL ENTRY IS LIKELY TO GENERATE ENORMOUS CONSUMER BENEFITS

15. To the extent that the proposed transaction accelerates entry into the provision of local services, it is likely to have enormous benefits to consumers.

16. First, the success of one entrant is likely to facilitate entry by others. Successful entry generates information that subsequent entrants can use in deploying new technology, establishing efficient interconnection arrangements with ILECs, and developing of marketing strategies. Much in this way, MCI's success in providing long distance services facilitated the entry and/or expansion of Sprint, WorldCom and other network operators and resellers.

17. Second, successful entry into the provision of local service is likely to have large consumer benefits simply because of the enormous size of the market. As summarized in Table 2, data from the FCC indicates that consumers spent about \$108 billion in 1996 on local exchange services. The margin earned by local exchange providers was more than 45 percent.¹¹ As a point of comparison, aggregate toll revenue for long distance carriers in 1996 was about \$50 billion (excluding access charges).¹² Margins earned by AT&T and Sprint

10. Lehman Brothers, Inc., "1998: The Year of Accelerating Telecom Consolidation," p. 1, 4.

11. Gross margin is defined to reflect revenue less network operating costs as a percentage of revenue.

12. FCC, TRS Fund Worksheet Data, November 1997.

Table 2

**Industry Revenue and Margins
1996**

	<u>Interexchange Carriers</u>		<u>Local Exchange Carriers</u>
	Including Access Charges as Rev- enue	Excluding Access Charges as Reve- nue	
Revenue (\$ billion) ^{1/}	\$79.1	\$50.4	\$107.9
Gross Margin	22% ^{2/}	34% ^{2/}	49% ^{3/}

1/ TRS Fund Worksheet Data.

2/ Based on 10K filing for AT&T (Communications) and Sprint (Long Distance Division). Gross margin defined as revenue (excluding access charges) less SG&A and operations/network cost.

3/ Based on FCC statistics of Communications Common Carriers. Gross margin is defined as operating revenue less general and administrative expenses and plant operating expenses.

were roughly 35 percent in 1996; if access charges are included in revenue, long distance margins were roughly 20 percent.¹³

18. Under these circumstances, even a modest acceleration of entry into the provision of local service with a modest effect on price can generate very large consumer benefits.

C. THE TRANSACTION SHOULD RAISE NO COMPETITIVE CONCERN REGARDING HARM TO LOCAL COMPETITION

19. Petitioners suggest that the proposed transaction may adversely affect competition in the provision of local exchange services.¹⁴ Any such concerns, however, are unwarranted.

20. There is no dispute that the ILECs account for an overwhelming share of local customers and revenues in all areas of the country. Combined, CLECs and CAPs, including WorldCom and MCI, today account for only a tiny share of local access customers and revenues. As shown in Table 1, FCC data for 1996 indicate that the combined revenue for CAPs and CLECs (from all sources) is roughly one percent of total LEC revenues. While the CLECs' revenue has grown, it continues to account for only a de minimis share of all local exchange revenue.¹⁵

13. The rough accuracy of these calculations are confirmed in reports by industry analysts. Credit Suisse First Boston, for example, reports that MCI had an EBITDA margin of about 20 percent, with the comparable figure among RBOCs being 40-45 percent. (Credit Suisse First Boston, WorldCom, Inc. -- Company Report, November 18, 1997.)

14. See GTE petition, p. 43 and Bell Atlantic petition, p. 17.

15. Even in the New York metropolitan area, the region which perhaps has attracted the most entrants into the provision of local service, the ILEC still accounts for 94 percent of business access lines. (New York Public Service Commission, January 15, 1998)

21. Under these circumstances, CLECs must price their services based on rates offered by the ILECs. There is no conceivable way that MCI WorldCom, with a de minimis share of local service customers, could exercise market power and find it profitable to significantly raise their prices. Although somewhat simplified, the textbook model of a dominant firm (e.g., an ILEC) facing a competitive fringe seems a reasonable approximation here. In that model, fringe firms compete against the dominant firm that sets price.

22. The FCC's order in the Bell Atlantic/NYNEX matter also suggests that it would be unlikely that the proposed transaction would harm competition.¹⁶ In that case, the FCC ultimately approved a merger between the incumbent LEC (NYNEX) and a potential entrant (Bell Atlantic) that the FCC considered to be one of the four firms most likely to enter into the provision of local service in New York City.

23. In contrast, the proposed WorldCom/MCI transaction involves two non-incumbent firms that together account for less than one percent of local exchange revenue, one of which (WorldCom) the FCC did not consider to be a significant potential entrant. In the Bell Atlantic/NYNEX Order, the FCC found that AT&T, Sprint and MCI (in addition to Bell Atlantic) were the most likely entrants to the provision of local service in the New York area. WorldCom was considered among a group of less significant potential providers that included other CAPS, cable system operators, mobile telephone service providers, and non-adjacent out-of-region Bell companies. Thus, with respect to local competition, this merger at most reflects a consolidation of two of many fringe firms that are providing or could provide local service.

16. FCC Memorandum and Order, Applications of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX and Its Subsidiaries, August 14, 1997, (Bell Atlantic/NYNEX Order).

III. LONG DISTANCE: IT IS HIGHLY UNLIKELY THAT THE PROPOSED TRANSACTION WILL ADVERSELY AFFECT COMPETITION IN THE PROVISION OF EITHER WHOLESALE OR RETAIL SERVICES

24. Petitioners distinguish between the wholesale and retail segments of the long distance industry, and within the retail segment, between business and residential customers.¹⁷ Petitioners claim that the proposed transaction will adversely affect competition in each of these segments.

25. This section separately evaluates the effect of the proposed transaction on each of these industry segments. The evidence that we have examined to date convinces us that it is highly unlikely that the proposed transaction would have an adverse effect on competition. We also find that the evidence presented by petitioners is not relevant to an evaluation of the proposed transaction on competition. More specifically, we find: (i) petitioners' analysis of wholesale competition ignores the rapid entry and expansion of fiber optic capacity that is now occurring; (ii) petitioners' arguments implicitly acknowledge that the proposed transaction is unlikely to adversely affect competition for residential customers because WorldCom plays a limited role in this segment; and (iii) evidence cited by petitioners generally fails to claim that business customers face "inadequate" competition.

17. As an approximation, the wholesale segment of the industry includes functions relating to call transport and switching; the retail segment of the industry relates to customer service, billing and marketing. In practice, however, this distinction is blurred. For example, some products, such as dedicated DS-3 lines, are sold to both wholesale and larger retail business customers. Firms such as non-facilities based resellers that participate exclusively in the retail segment would not be considered participants in the wholesale segment. The fiber optic capacity used to provide wholesale transport of long distance calls also can be used to provide Internet and other telecommunications services. Therefore, the wholesale transport of long distance telephone calls should be considered as part of the broader market of fiber optic transport capacity.

A. STANDARDS FOR MERGER EVALUATION

26. The relevant question in merger analysis is: How will the proposed transaction adversely affect competition? None of the evidence presented by petitioners directly addresses this question.

27. Petitioners' claims are based in part on economic studies submitted by the Regional Bell Operating Companies to support their applications to provide within-region long-distance services.¹⁸ These studies attempt to evaluate whether the industry is now "competitive" and whether the entry of RBOCs into the provision of interexchange services in their home region is desirable. As a general matter, all else equal, entry into an industry is desirable. However, even in industries where entry might benefit consumers, mergers do not necessarily lessen competition and indeed generally create efficiencies. Thus, mergers are routinely approved in industries that are not perfectly competitive even though entry into such industries might be likely to benefit consumers. The studies cited by petitioners simply do not address and hence cannot be used to support the proposition that the proposed merger would adversely affect long distance.

28. Petitioners' calculations of "market shares" and HHIs based on long distance providers' revenue or subscriber base also fail to support their claim that the proposed transaction will result in harm to consumers. The use of "market share" estimates and HHIs is at best only a first step in any analysis of competitive issues. Petitioners do not rely on any economic

18. BellSouth attaches affidavits by Jerry Hausman and Richard Schmalensee that were submitted in support of its application to provide within-region interLATA services in South Carolina. GTE cites: Affidavit of Robert Crandall and Leonard Waverman in Support of Ameritech's Section 271 Application for Michigan (filed May 21, 1997); Declaration of Professor P. MacAvoy, The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services, MIT Press, 1996; and J. Hausman's BellSouth affidavit.

study to show that changes in concentration associated with this transaction will adversely affect competition.

29. Specifically, even though an HHI analysis can be a useful starting point to judge the likely competitive consequences of a merger, the significance of industry concentration and its predicted change resulting from the merger must be judged in light of industry facts. And, as discussed below, a key new fact in this industry is the dramatic and recent large scale entry that was not widely anticipated even a few years ago. Even in an industry with a high HHI, a merger need raise no competitive concerns in the face of large-scale entry.

30. An analysis of the effect of a merger on competition needs to address forward-looking considerations, including entry conditions and the growth in industry capacity. Petitioners simply ignore the large-scale entry and expansion in capacity that has occurred and that now is being undertaken in the industry.

31. The review of mergers by antitrust enforcement agencies is based in large part on the concern that increases in concentration resulting from a merger will facilitate collusion resulting in higher prices to consumers. It is highly unlikely that collusion could succeed in the presence of rapid technological changes, entry and expansion in capacity.

B. SIGNIFICANT ENTRY OF NATIONWIDE FIBER OPTIC NETWORKS AND THE ABSENCE OF ENTRY BARRIERS MAKE IT HIGHLY UNLIKELY THAT THE PROPOSED TRANSACTION WILL ADVERSELY AFFECT WHOLESALE LONG DISTANCE COMPETITION

32. Petitioners devote extended discussion to the claim that wholesale competition will be adversely affected by the proposed transaction, stressing that there are now four major national fiber optic networks. This view is far too narrow and ignores the dramatic changes now taking place in the wholesale marketplace. Moreover, the economic studies cited by petitioners do not generally address whether the wholesale segment is subject to competitive problems.

Indeed, as discussed in Section C below, evidence cited by petitioners generally does not suggest that competition for business customers is inadequate. Hence, logic suggests that there should be no complaints about wholesale long distance. If large business customers can negotiate favorable rates then large wholesale customers should be able to do so as well. This logic is further reinforced by the fact that some products are sold to both wholesale and retail business customers.

33. Today, new national, high-capacity fiber optic networks are being deployed and other entrants have recently announced plans to deploy national, high capacity fiber optic networks. In addition, regional networks are being deployed and expanded. Each of these entrants, which are discussed in more detail below, is managed by individuals with significant industry experience, are well-financed and are highly credible. Within about two years, it is likely that there will be seven national fiber optic networks (after accounting for the consolidation of the MCI WorldCom networks), not to mention a significant number of regional networks and the possibility of still further entry. These seven networks include MCI WorldCom, AT&T, Sprint, Qwest, IXC, Williams and Level 3. As described more fully below, each of these firms will have substantial national capacity. Since the new networks have pre-sold capacity to other firms that independently provide services using these facilities, there will effectively be more than seven national network operators.¹⁹ Furthermore, these network providers sell services to highly sophisticated firms that purchase large amounts of capacity which in turn is sold to consumers of a variety of telecommunications services.

34. Petitioners, however, fail to discuss these current circumstances. They instead present "market share" calculations, but fail to show why these figures are relevant to an

19. One of these new network operators is GTE, the firm which now complains that it will be victimized by the reduction in wholesale competition. (See GTE press release at <http://www.gte.com/g/news/050697.html> as well as GTE advertisement in the Wall St. Journal, January 21, 1998, pp. A8-A9.)

analysis of how competitive conditions would change as the result of the proposed transaction especially in light of the ongoing entry.

35. In light of the current and expected future entry, it is highly unlikely that the proposed transaction would adversely affect competition in the provision of wholesale long distance services. Experience indicates that competitive problems are rare in industries with a significant number of competitors, rapid entry and expansion of capacity, and sophisticated buyers. The remainder of this section documents the nature of this entry and its likely effect on competition in the provision of wholesale capacity.

1. Qwest and IXC are significantly expanding wholesale capacity

36. There is a tremendous amount of entry and expansion of wholesale fiber optic capacity now occurring in the U.S.²⁰ As the Wall St. Journal recently noted, "[t]he telecom industry is being shaken to its circuit switches by network upstarts that are building new systems promising far faster transmission and lower operating costs than the vast systems now being run by AT&T Corp., the Bell companies and others."²¹

37. Among several firms constructing new fiber optic networks, Qwest and IXC merit attention as significant examples of the more general phenomenon now taking place in the industry. Each of these firms are in the process of deploying national fiber optic networks, each of which promises to be greater in scope than WorldCom's current network. These two

20. Fiber optic capacity can be used for voice telephony as well as other telecommunications applications including data, Internet, video, etc. Thus, as explained in more detail below, entry and expansion in the wholesale market also makes it highly unlikely that the proposed transaction will adversely affect competition in the provision of other telecommunication services, such as Internet backbone services.

21. Wall St. Journal, Jan. 20, 1998, p. A3.

networks alone will result in more than a 35 percent increase in the fiber optic route miles relative to the roughly 100,000 fiber route miles deployed at the end of 1996.²²

38. Qwest is deploying a national fiber optic network that upon completion will cover roughly 16,000 route miles.²³ In comparison, WorldCom's network at the end of 1996 encompassed roughly 12,000 route miles.²⁴ Network construction is scheduled to be completed in the second quarter of 1999, a little over a year from now. IXC is deploying a national fiber optic network that will cover more than 20,000 route miles by the end of next year. Today, IXC's network encompasses roughly 12,000 route miles.²⁵

39. Simple route mile measurements, however, implicitly understate the increase to wholesale capacity created by Qwest and IXC. First, fiber optic networks vary with respect to the number of fibers per cable deployed and FCC data indicate that the four national networks include an average of between 20 and 32 fibers per cable. In contrast, Qwest reports that it is generally deploying cables with 96 fibers throughout its network.²⁶ The IXC network will generally contain between 48 and 72 fibers.²⁷ Second, the new networks will employ advanced electronic technologies that enable a greater volume of traffic to be transmitted per fiber optic strand. Merrill Lynch, for example, reports that "Qwest will have the lowest cost, highest

22. FCC, Fiber Deployment Update, End of Year 1996.

23. Qwest Form 10Q, November 15, 1997, p. 19.

24. At the end of 1996, MCI and Sprint each had fiber optic network encompassing roughly 23,000 route miles and AT&T's system included 39,000 route miles. FCC, Fiber Deployment Update, End of Year 1996, Table 1.

25. IXC Form S-4, October 3, 1997.

26. Qwest Prospectus, June 24, 1997, p. 41.

27. Fiber Optics News, May 5, 1997.

technology network available."²⁸ Another analyst describes IXC's network as "state of the art."²⁹

The use of enhanced electronics implies that the effect of these two entrants on industry capacity will be far greater than implied by the number of miles of fiber encompassed by their networks.

40. The competitive significance of these two new networks is further enhanced by the fact that the capacity in these networks will be owned and operated by a variety of independent firms, not only Quest and IXC. As noted in Network World, "the new long-distance carriers have presold their capacity in gigantic chunks to second-tier retail operators and ISPs."³⁰

41. Qwest, for example, has already sold significant portions of its national network to Frontier and GTE and portions of its network to other carriers, who will use this capacity to compete as independent firms.³¹ IXC has sold capacity to WorldCom, LCI, Vyvx, MCI, DTI, CCTS, and GST.³² With their remaining capacity, both Qwest and IXC intend to provide services to other carriers, such as long distance resellers, other long-distance network operators, and Internet backbone providers.³³ Services provided on the portions of the network sold to others may in turn be sold to resellers, marketed directly by the new firms or sold to yet others. In any of these circumstances, the new owners will compete with Qwest, IXC, each other and other network operators.

28. Merrill Lynch, Long Distance, August 15, 1997, Appendix 5.

29. Research Note, Robinson-Humphrey Company, December 22, 1997.

30. Network World, January 12, 1998, p. 8.

31. Qwest Prospectus, p. 43.

32. IXC Communications Inc., Form S-4, October 3, 1997, p. 8.

33. Qwest Prospectus, p. 44; Communications Week International, October 20, 1997, p. 4.

42. In sum, these two new entrants alone will significantly increase the effective fiber optic capacity and wholesale competition. Nonetheless, petitioners never mention these firms in analyzing the effect of the proposed transaction on wholesale competition.

2. There are additional examples of entry and expansion into the provision of wholesale services

43. Qwest and IXC are only two among many examples of entry and/or expansion of wholesale capacity. For example:

- Level 3 Communications recently announced plans to spend \$3 billion to build a global Internet-based local and long-distance network. Level 3's U.S. network is expected to encompass 20,000 route miles, making it comparable in size to IXC and Qwest. Completion is expected in late 1999.³⁴
- Williams Co. recently announced that it will reenter the provision of wholesale telecommunications business.³⁵ Williams previously operated a national fiber optic network that was sold to WorldCom in 1995, retaining certain rights to use one fiber optic strand in this network. It recently revealed plans to spend \$750 million over the next two years for expanding its network. This is roughly half the cost of constructing the Qwest Network.³⁶ Williams also announced that US West will be the "anchor tenant" in its network, which is expected to cover more than 18,000 route miles by the end of 1998.³⁷

34. Wall St. Journal, January 20, 1997, p. A3.

35. New York Times, January 12, 1998, Section D, p. 10.

36. Qwest Communications International Form S-4, June 30, 1997, p. 7.

37. US West press release, January 5, 1998 (<http://www.uswest.com/com/insideusw/news/010598.html>).

- Aliant Communications recently expanded its fiber optic network and formed the Midwest Carrier Consortium with a variety of regional networks including Norlight Telecommunications (Wisconsin); Minnesota Equal Access Network, Iowa Network Services, KIN Network (Kansas), and others.³⁸
- LCI, which operated a 1,400 mile network at the end of 1996, has purchased more than 5,500 fiber miles of previously dark capacity in the past year from Williams and IXC.³⁹
- Cable and Wireless plans to "significantly increase [its] fiber optic network within the U.S." with a \$130 million investment this year.⁴⁰

44. Future entry and expansion of capacity is also facilitated by the presence of empty conduit often installed during network construction.⁴¹ The availability of such capacity enables network owners to deploy and sell additional capacity without acquiring new rights of way. As mentioned above, network capacity can also be expanded through the use of enhanced electronics in combination with already-deployed fiber optic cable.

45. Furthermore, a wide variety of telecommunications firms have the ability to provide wholesale long distance services. Potential entrants include foreign PTTs, and electric utilities as well as RBOCs, if they fulfill the criteria required by the 1996 Telecommunications Act. Even if RBOCs fail to fulfill these criteria, there are no barriers to their ability to provide services (at either the wholesale or retail level) outside of their home territory.

38. Fiber Optics News, January 5, 1998.

39. LCI press releases, February 4, 1997, October 14, 1997.

40. http://www.cwix.net/about_cwix/fiberoptic.shtml.

41. Qwest Prospectus, p. 41 and Fiber Optics News, December 15, 1997.

46. Overall, current industry developments indicate that there are no significant barriers either to the expansion of existing capacity by network operators or to the entry of new firms into the provision of wholesale services and further indicate that such entry is rapidly occurring. Such circumstances make it highly unlikely that the proposed transaction will have an adverse effect on competition in the provision of wholesale long distance services.

C. IT IS HIGHLY UNLIKELY THAT THE TRANSACTION WILL ADVERSELY AFFECT RETAIL LONG DISTANCE COMPETITION

1. Petitioners acknowledge that WorldCom has little brand recognition among residential customers

47. BellSouth, GTE and Bell Atlantic each emphasize that WorldCom has historically played a limited role in marketing directly to residential consumers, instead primarily serving these customers through resellers. They acknowledge that, unlike MCI, WorldCom has little retail brand recognition among residential consumers. As GTE states in its petition (at p. 25), WorldCom "[recognizes] that its own brand name is largely unrecognized in the retail mass market."

48. There is no dispute about this claim. While WorldCom actively markets to residential consumers, it has placed greater emphasis on marketing to business consumers. WorldCom's lack of brand recognition among residential customers was one factor that led to the FCC's finding in Bell Atlantic/NYNEX that WorldCom was not among the most significant potential entrants to provide local service in New York City.

49. WorldCom's lack of brand recognition among retail customers, however, implies that the proposed transaction would not be likely to have an adverse effect on competition for residential customers. WorldCom is only one among many firms, including facilities-based and non facilities-based resellers, that provide service to residential customers. Many of these firms

have been able to expand rapidly. For example, between December 1994 and December 1996, Excel's pre-subscribed lines increased from roughly 75,000 to 3.8 million.⁴² Excel claims to rank fourth (after AT&T, MCI and Sprint) in terms of revenue derived from domestic residential long distance.⁴³ As another example, Telco, a provider of dial-around services, realized an increase in revenue from \$1 million in 1993 to \$428 million in 1996.⁴⁴

50. These facts suggest that WorldCom is just one of many firms lacking strong brand recognition that can offer long distance services to residential customers. Under these circumstances, there is little risk that the transaction will adversely affect competition in the retail segment of the long distance industry.⁴⁵

2. The proposed transaction would not be expected to lessen Worldcom's commitment to residential service

51. Bell South simultaneously claims that (i) residential long distance service is characterized by supracompetitive pricing; and (ii) that MCI WorldCom would lessen its commitment to or abandon its residential customer base. Bell South, however, offers no explanation

42. FCC, Long Distance Market Shares, Third Quarter 1997, Table 2.1.

43. Excel Communications Inc. Form 10-K, December 31, 1996.

44. Telco Annual Report, 1996, p. 10. Telco was acquired by Excel in mid-1997. (<http://www.exceltel.com/hotnews/merger.htm>)

45. Notice how our conclusion is based on an analysis of changes in competition resulting from this transaction. In contrast, petitioners cite testimony submitted in previous proceedings that residential competition is inadequate -- testimony which does not examine the likely change in competition resulting from this transaction. Even the evidence cited by petitioners has been strongly challenged. (See accompanying affidavit of Robert Hall.)

why MCI WorldCom would find it in its interest not to serve such valuable customers (or not to sell the business of providing such services to a qualified buyer).⁴⁶

52. More generally, there is no reason to expect that MCI WorldCom would lessen its commitment to serving residential customers. If it is now profitable to serve such customers, there is no reason to expect that this situation would change as the result of the transaction.

3. Evidence cited by petitioners does not support their inference that the transaction will harm competition for business customers

53. As noted above, petitioners' claims that the proposed transaction will adversely affect competition rely principally on affidavits submitted by RBOCs in support of their applications to provide within-region interLATA service. These affidavits, however, at most permit an inference that the residential segment of the retail long distance industry is imperfectly competitive. The studies generally do not claim that the business segment of the retail long distance industry is subject to competitive problems, nor do they generally address whether the wholesale segment is subject to competitive problems.⁴⁷

54. For example, the affidavits by Prof. Richard Schmalensee and Prof. Jerry Hausman attached to BellSouth's petition do not claim that business customers face inadequate competition. In a section of his report entitled "Inadequate Competition for the Consumer Market," Prof. Schmalensee states:

"Although large business customers have benefited from competition in the interexchange market, competition for the consumer market is inadequate."⁴⁸

46. A qualified buyer would be one for whom the acquisition of the business would not violate the antitrust laws.

47. As a matter of economic logic, the absence of competitive problems for business customers implies the absence of competitive problems at the wholesale level as well.

48. Declaration of Richard L. Schmalensee, August 18, 1997, attached as Appendix C to
(continued...)

55. Prof. Hausman's affidavit includes the following statement:

"Current *residential* long distance prices are above the competitive level."⁴⁹
[Emphasis added.]

56. The absence of significant competitive problems among business customers is also recognized by Prof. Marius Schwartz in an affidavit submitted by the U.S. Department of Justice in response to various RBOCs' applications to provide within-region long distance services. He concludes that: "[h]igh volume [business and residential] customers already enjoy substantial competition."⁵⁰ This view is echoed by the U.S. Department of Justice, which stated in its brief that "higher volume residential and business customers benefit from considerable rivalry."⁵¹

D. THERE IS NO BASIS FOR GTE'S CLAIM THAT THE MERGER WILL ELIMINATE A "MAVERICK" FIRM

57. GTE claims that the proposed transaction will eliminate WorldCom as a "maverick" firm. Assuming that GTE is correct in its characterization of WorldCom as a maverick, there is no sound economic basis for their claim.⁵² A maverick is different from a firm with a small market share. The term instead typically is applied to firms that have a history of disrupting stable industry relationships. Although MCI WorldCom will be considerably larger

48.(...continued)
the BellSouth petition, ¶ 7.

49. Declaration of Professor Jerry Hausman, ¶ 28.

50. Supplemental Affidavit of Marius Schwartz on Behalf of the U.S. Department of Justice, November 3, 1997, p. 31.

51. Evaluation of the U.S. Department of Justice in the matter of: Application by BellSouth Corporation, et. al. for Provision of In-Region, InterLATA Services in South Carolina, before the F.C.C., CC Docket No. 97-208, November 4, 1997, p. 48.

52. Given MCI's history, it is unclear why GTE does not also describe MCI as a maverick.

than WorldCom today, the transaction does not remove the maverick from the marketplace. Instead, the transaction results in the maverick having control of more capacity with which to alter the status quo, if one can be said to exist in the telecommunications industry.

58. GTE suggests that as a result of the proposed transaction WorldCom will no longer be willing to disrupt the industry by providing services to resellers. Once again, however, GTE presents no support for this argument. As discussed above, numerous firms are acquiring control of wholesale capacity with the specific goal of providing service to other carriers. A strategy by MCI WorldCom of reducing cooperation with resellers likely would result in the loss of customers to what will soon be at least six other competing national networks without benefit to MCI WorldCom. Like WorldCom and MCI today, MCI Worldcom will need to compete vigorously with existing network suppliers and entrants to order to retain wholesale customers and attract new ones.

IV. INTERNET SERVICES: UNPRECEDENTED GROWTH AND ENTRY MAKES IT HIGHLY UNLIKELY THAT THE PROPOSED TRANSACTION WILL ADVERSELY AFFECT COMPETITION

59. As discussed earlier, it is unlikely that a transaction would adversely affect competition in an industry characterized by rapid entry, expansion of capacity and technological change. The provision of Internet backbone services clearly meets these criteria. The rapid expansion of fiber optic capacity makes it highly unlikely that the proposed transaction will adversely affect competition because the availability of such capacity facilitates entry into the provision of Internet backbone services.

60. Petitioners' claim that the proposed transaction will adversely affect competition in the provision of Internet backbone services is based on unreliable "market share" calculations from an industry trade publication. Once again, however, petitioners present no analysis to support their claim that these market shares are relevant to an analysis of how competitive

conditions in the industry would be expected to change as the result of the proposed transaction and they ignore the dramatic recent ongoing entry.

A. THE AVAILABILITY OF FIBER OPTIC CAPACITY MAKES IT HIGHLY UNLIKELY THAT THE PROPOSED TRANSACTION WOULD ADVERSELY AFFECT INTERNET BACKBONE COMPETITION

61. The same fiber optic capacity can be used to provide telephone services, Internet services, and a variety of other data and video applications. As a result, the analysis of the proposed transaction on the provision of Internet services raises many of the same issues addressed above in the discussion of wholesale long distance issues above. In particular, the rapid entry and expansion of fiber optic capacity reduces the likelihood that the transaction will have an adverse effect on competition in the provision of Internet services, just as with wholesale long distances services.

62. The likelihood that the transaction will result in harm to Internet competition is made even more remote because entry into the provision of backbone services does not require construction of a new fiber optic network. Internet backbone providers can simply lease or buy fiber capacity from wholesale suppliers and attach the requisite routers and other equipment required to provide service. Boardwatch magazine, which follows the Internet industry, highlights the difficulty of any attempt to exercise market power in such an environment. In discussing the consequences of a hypothetical attempt to impose an undesired pricing policy on the industry, Boardwatch writes:

"If anyone doesn't buy in -- say a Qwest Communications, or anyone else capable of providing actual fiber routes, any one of now 4,535 ISPs can rent some fiber, declare themselves a backbone, and [traffic] will simply move to PSI or Qwest or AT&T or whoever is hungry enough for market share to operate an Internet in the fashion already demonstrated."⁵³

53. Boardwatch, November 1997, p. 10.

B. THERE HAVE BEEN SIGNIFICANT ENTRY AND DRAMATIC INCREASES IN INTERNET BACKBONE DEMAND AND CAPACITY IN RECENT YEARS

63. The growth in demand for Internet services has little if any precedent. A recent industry report by Maloff Group International summarizes recent trends:

"[t]he Internet Service Provider (ISP) marketplace in the U.S., including Information Providers, grew from an estimated \$1.85 billion (annualized revenue as of April 1996) to \$8.4 billion (annualized revenue as of October 1997).⁵⁴

64. There is no indication that the demand for Internet service has peaked. Maloff, for example, forecasts that the demand for Internet services will grow "to nearly \$50 billion by the end of the year 2000."⁵⁵

65. A large number of firms are competing to establish positions in this marketplace. The Fall 1997 industry directory published by Boardwatch Magazine identifies 34 "national backbone providers" (even after accounting for the proposed consolidation of UUNet, ANS, Compuserve and MCI). Rival network providers include AT&T, Sprint, GTE, IBM, PSINet, among many others.

66. Boardwatch acknowledges that its list of backbone providers is incomplete:

"Defining a national backbone is problematic at best. There are many more backbones existing in the country that we could have included in this issue, but most of them are regional in nature, such as Colorado SuperNet, which has trunk connections throughout Colorado and a few surrounding states."⁵⁶

67. Boardwatch's Fall 1997 list of national providers includes seven national backbone providers not identified in its Summer 1997 directory. As recently as the summer of

54. Maloff Group International, Inc., Internet Access Providers Marketplace Analysis, October 1997, p. 7.

55. Ibid., p. 8.

56. Boardwatch Quarterly Directory of Internet Service Providers, Fall 1997, p. 27.

1996, Boardwatch identified only 9 national backbone providers.⁵⁷ Boardwatch also identifies 4,354 ISPs in its current directory. As noted above, these firms can vertically integrate into the provision of backbone services by leasing fiber optic capacity.

68. Boardwatch emphasizes that there continues to be rapid entry into and expansion of Internet backbone services:

"... [T]his continues to a terribly dynamic and exciting area. All national providers are expanding the number of points of presence and building or upgrading backbones at an incredible rate."⁵⁸

69. To cite two recent examples, Internet backbone provider Apex Global Internet Services (AGIS) recently obtained capacity along 10,000 miles of Qwest's network.⁵⁹ Similarly, GTE, which raises concerns regarding "the substantial anticompetitive impact of the proposed transaction on the Internet market,"⁶⁰ boasts in the advertisement cited earlier that:

"We're now one of the largest providers of Internet solutions to business. And we're deploying a 15,000-mile data network stretching from the eastern seaboard to the California Coast. It will expand the GTE network to 100 times the size of today's Internet."⁶¹

70. In new and growing industries, such as the provision of Internet backbone services, differences in expectations regarding future demand and technological changes are likely to result in substantial divergences in firms' interests, greatly complicating collusion. The entry of numerous large scale firms who provide fiber optic capacity make it even more unlikely that this merger will result in supra-competitive pricing. As a result, it is highly unlikely that the proposed merger will adversely affect competition in this industry.

57. Boardwatch Internet Service Providers Guide, Summer 1996.

58. Boardwatch Quarterly Directory of Internet Service Providers, Fall 1997, p. 21.

59. Fiber Optic News, January 12, 1998.

60. GTE petition, p. 46.

61. Wall St. Journal, January 21, 1998, pp. A8-A9.